$50.00 ANNUALLY
40 Letters Per Year

Dow Theory Letters

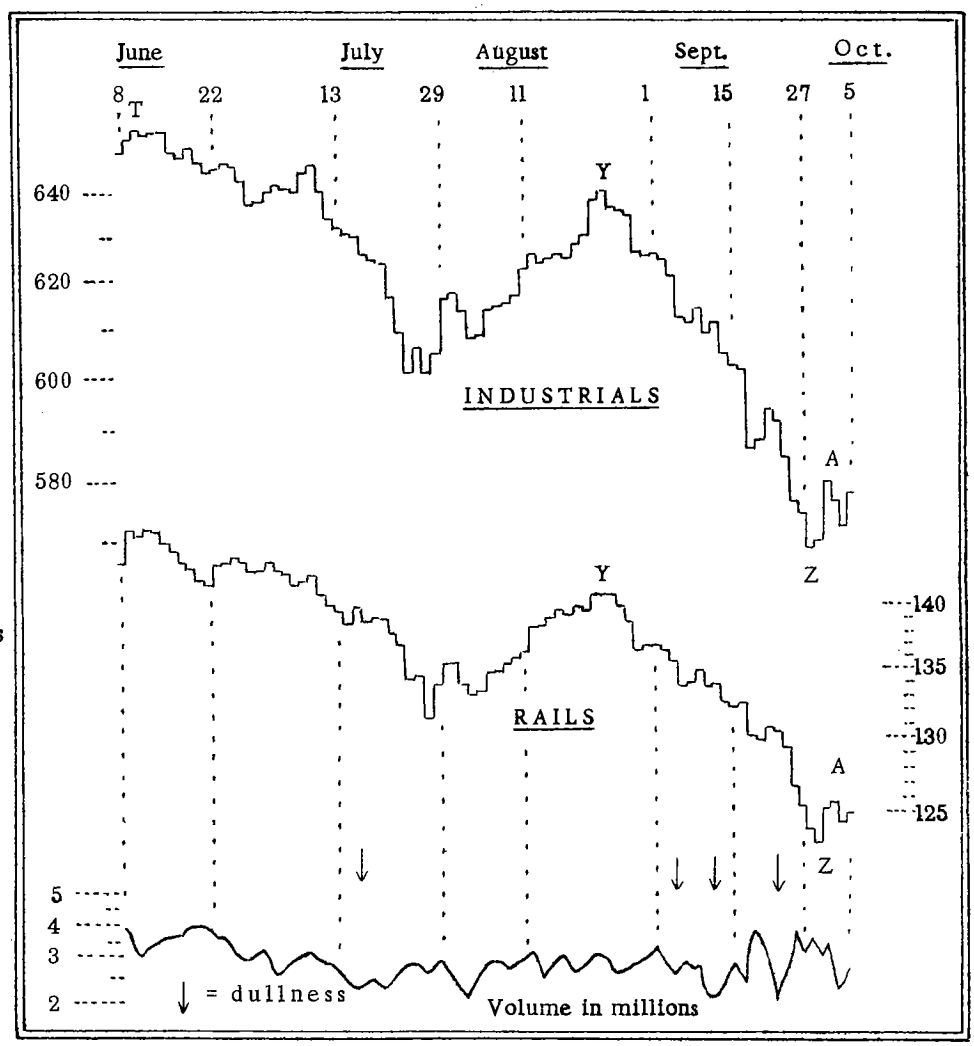
"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
125 East 93rd Street
New York City 28

Registered with the Securities and Exchange Commission
All Rights Reserved

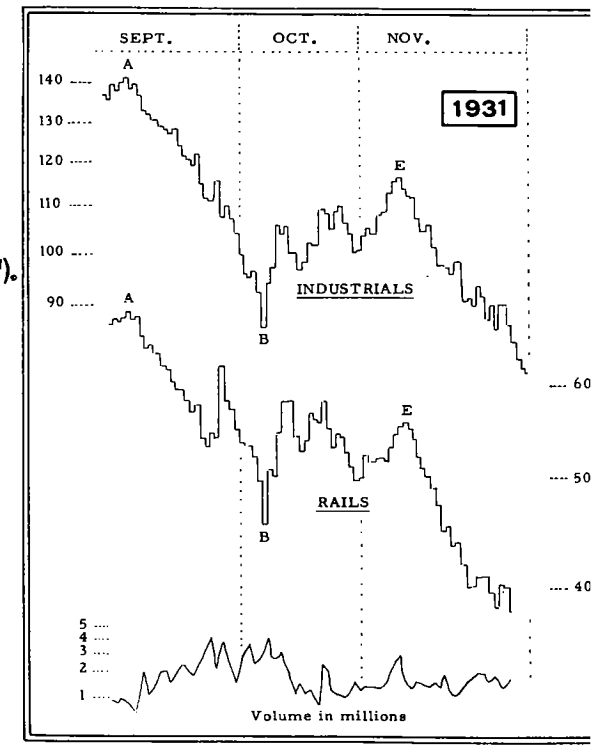
THE MARKET Last Tuesday the New York World Telegram quoted a well-known Wall Streeter as saying: "I continue to believe that we are in a great bull market." A prominent brokerage house advertised in last Sunday's New York Times: "THE LOWER THIS MARKET GOES THE MORE BULLISH IT LOOKS." The first quote is wishful thinking, the second is a semantic absurdity (and would have made as little sense in 1929, 1930, 1931 or 1932). During the same week Secretary of the Treasury Anderson declared, "...it is my strong view that the outlook for economic activity in this country is favorable, both for the near future and for many years ahead." Backing him up, Budget Director Stans stated that he was confident of "...a normal seasonal improvement in business conditions, and it might be somewhat better than that." The last two opinions are political and may be excused on those grounds. In all, however, there seems to be a general inability to recognize that the tide has turned down. Moreover, the nation's leading spokesmen and analysts do not seem to understand that while there is a time for optimism and high-flown words, there is also a time for fact-facing and hard reality. It is my opinion that the worst possible damage is now being done by those who will not face what is happening in the country and in the market.

I am reproducing a chart which shows a period of typical bear market action (1931). Although the overall price pattern during the 1931 period was quite similar to the current pattern, I want to call particular attention to the "bouncing" action of the Averages and the "turn on a dime" violent reversals to the upside. Notice the numerous one-day rallies which punctuated the decline from points A and E in 1931, and compare these with the price movements on today's chart. Note also the sharp fluctuations in volume and the one or two-day periods of dullness followed by renewed declines.



The current downward leg (which started at T) has produced many typical dull spots, and I have marked these on the chart with an arrow. Whereas dullness during bull markets is usually bullish (it signifies an absence of liquidation),

during bear markets dull areas are often the prelude to the next decline.



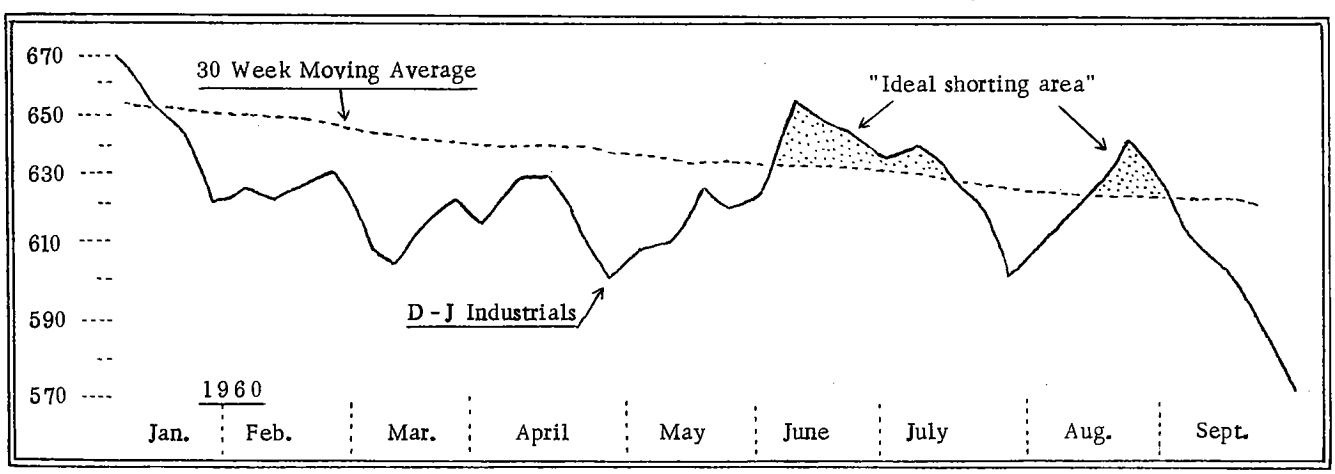
The primary leg which began at 656.42 (June 9) has erased 72 points from the Industrial Average. The probability that this downward leg will extend itself was discussed in the last Letter, and that discussion is amplified in today's mailing (see "PROBABILITIES"). The last Letter also noted that on a short-term basis (judging from the preponderance of declining days) a rally was overdue. A 9.55 point Industrial rally did occur on September 30, followed by three days of rather indecisive action.

This writer will cover the better part of his shorts in the event of (1) A sharp break below Z accompanied by heavy volume, or (2) an upward zig-zag which takes both Averages above the A points. The only important downside points are the bear market lows at Z (Industrials 569.08, Rails 123.37). The first upside points of any significance are at A (Industrials 580.14, Rails 125.85). A joint penetration of A would signify that the minor trend is up and that the secondary trend may be turning up. In the latter event, a full correction of the T-Z leg would be in order.

(Note: As this Letter is written both Averages have bettered the A points on an intra-da basis).

MOVING AVERAGE Letter 112 described the usefulness of a long-term moving average of the D-J Industrial Average (a 30 week moving average was used). Observations over the years suggest that during bear markets the Industrial Average tends to remain below its long-term moving average; in bull markets the exact converse is true. Letter 112 went on to say: "Periodic reactions may penetrate above or below the moving average, but when those penetrations occur against the primary direction they usually constitute a buying or selling opportunity.

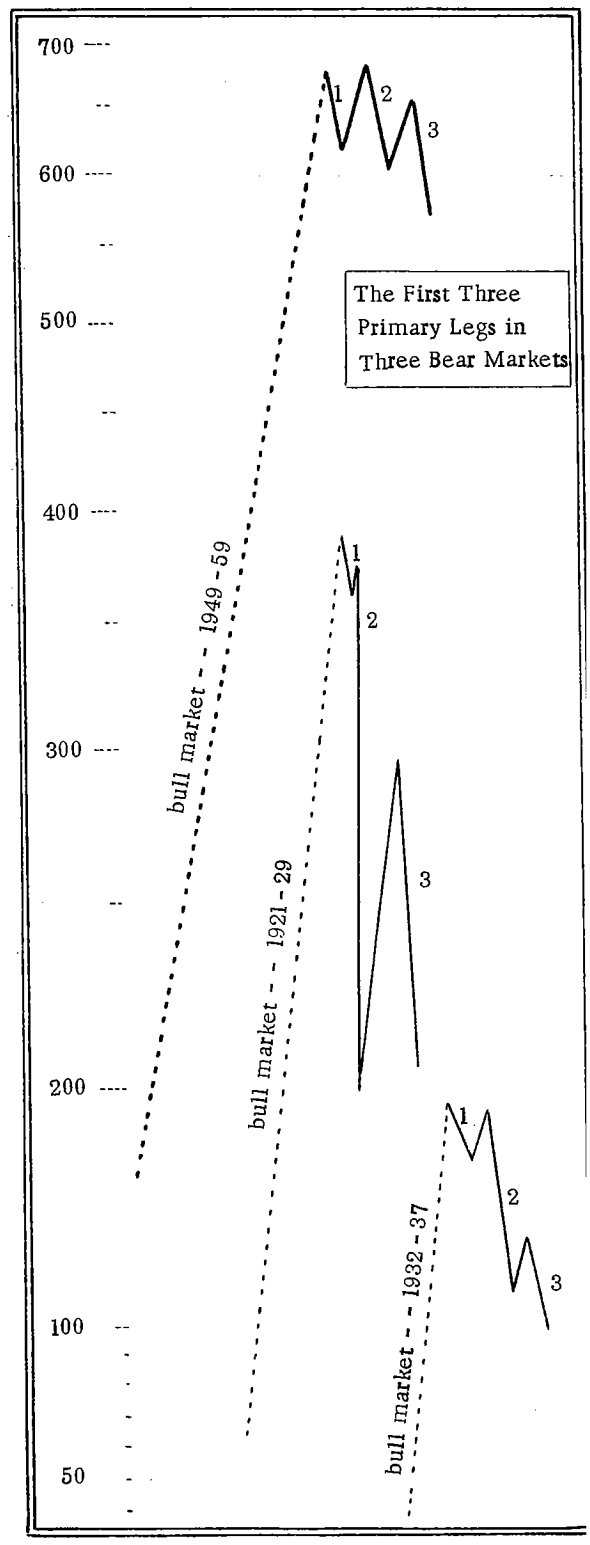
Note on the chart that the Industrials broke below the moving average in January, 1960, then rose temporarily above the moving average in June and early July. Since the June-July move was an upward penetration in a confirmed bear market, it provided an opportunity for shorting. Again for three weeks in late August and early September the Industrials rose above the moving average, and here (between 626 and 641) another excellent opportunity for shorting appeared. Had a trader shorted on either the June-July or August-September upward penetrations, he would now show a gain of about 55-85 D-J



Industrial points.

As a bear market progresses the long-term moving average tends to creep slowly into new low territory. On August 2, 1960 (Letter 112) the moving average was 625.72. As of this week the moving average had dropped to a new 1960 low of 619.37. With the D-J Industrials now at 578, the implication is that informed investors (the type that tend to buy the "blue-chip" Dow stocks) are now offering 48 points less for the Industrials than they were offering (on average) over the last 30 weeks. It also means that any advance which takes Industrials to or near the 619 area will provide another ideal opportunity for shorting.

PROBABILITY In these Letters I have stressed what I believe to be the primary principle of investing -- conservation of capital. I have always felt that possible capital appreciation, while vitally important (and certainly pleasant), is a secondary objective. It is a common practice among amateurs to try to "scalp" a bear market by buying into rallies or secondary (upward) reactions. While some floor traders and a few outsiders are successful in such operations, it seems to me that this procedure involves foresaking the primary consideration (safety of capital) in favor of the secondary one (possible appreciation). "Plenty of smart men would not think of shorting stocks in a bull market, no matter how fast the rally had been," wrote Rhea in November, 1937. "They know that to do so would be swimming against the tide; nevertheless, those same men are buying in this bear market after drastic declines, and this procedure is about as logical as shorting in a bull market. It is always good investment policy to buy into the early stages of a bull market, but the exact reverse is true as concerns bear markets. Buying in bear markets is mere gambling and not very good gambling at that." He continued: "Why not have cash instead of investments in bear markets? Why insist that one cannot afford to forego investment income when one day's price shrinkage may cancel several years' dividends? Why follow those who only know how to 'buy'? Why not try to profit by the wisdom of Dow and Hamilton and the classical Theory they left us? Why not try being fully extended in early stages of bull markets, getting stops behind profits when the market reaches its third and dangerous phase, and then remaining liquid in bear periods?"



Probabilities are an important consideration in any investment appraisal. When a great bull tide turns bearish there is no way of knowing how far the receding tide will carry. The prudent man, however, will study the probabilities (or at least possibilities) and then decide where the course of safety lies. There have been three great bull markets (in terms of percentages) since the 1920's. The bull market of 1921-29 advanced the D-J Industrial Average 487%; the bull market of 1932-37 advanced Industrials 372%; the 1949-59 bull market added 324% to Industrial values.

The 1929-32 bear market was composed of eight distinct primary downswings or legs. By the end of the third leg (in 1930) 50% of the value of the D-J Industrial Average had been wiped out (89% of Industrial values were lost by 1932). The 1937-38 bear market was completed in three primary legs. By the end of the third leg that bear market had erased 49.1% of the value of the Industrial Average. As to the current situation, taking the recent low of 569.08 (September 22, 1960), this bear market has (so far) wiped out 17% of the value of the D-J Industrials. The accompanying chart shows the termination points of the third legs in the 1929-32 and the 1937-38 bear markets; it also shows the position of the present bear market, which, of course, is now on its third primary leg. If past history has any validity the chart suggests that our thinking should continue to be directed towards safety.

It would be foolhardy to predict dogmatically that this bear market will

equal the 1929-32 or 1937-38 bear markets in intensity. It would be equally foolhardy to insist that it cannot. The 1946-47 bear market erased only 23% of the value of the D-J Industrials, and perhaps the current situation will be comparable. But as I value my hard-earned capital, I would rather let the market tell its own story without the benefit of my own or anybody else's hopes and wishes.

BEAR MARKET RALLIES Over the years I have built up a rather extensive card system which contains many hundreds of quotes from Dow, Hamilton and Rhea, each quote classified under such headings as "dullness", "bear market bottoms", "bull market psychology", etc. Periodically, as conditions warrant, I take off a few hours to review various sections of my file. One of the most difficult phenomena encountered by investors is the minor or secondary movement which goes counter to the primary trend. With this in mind, I have included a few quotes from my file section entitled "bear market rallies":

"The press and public are far more bearish now than sixty days ago. Worthwhile rallies usually start when that condition prevails." (Rhea - Nov. 10, 1937)

"When trying to pick the point where a bear market will probably turn down again after a secondary rally, it is often useful to watch professional opinion. More often than not, those soothsayers who were most wrong at the top of the bull market become bullish about the time a secondary rally peters out." (Rhea - Dec. 11, 1937)

"Perhaps it might be permissible to say that the secondary movement suspends for a time the great primary swing, although a natural law is still in force even when we counteract it." (Hamilton, 1922).

"In the secondary movement of the market the professional has a real and abiding advantage over the amateur. It is an emergency in which his technical experience tells. 'Tape reading' is a sort of sixth sense, and the man on the floor can feel a change coming even faster than the most accomplished tape reader if he has the aptitude for his work". (Hamilton)

Of a secondary reaction in a bear market Hamilton wrote: "It represents a technical market condition more than a summing up and reflection of general knowledge. It means that too many people are selling a bear market short regardless of the floating supply of stocks."

"In such action (bear market secondaries) the peak is frequently attained on a sudden increase in activity lasting a few days. It is usually impossible to pick the turn with any degree of precision; however, if, after the high point has been attained, a further rally shows a definite dimunition in activity, it is probable that an early resumption of the decline will occur." (Rhea, 1934)

"It has often been pointed out in these columns that the rally in a bear market is apt to be sharp and relatively short. Stocks seem to recover faster than they went down, and not infrequently from 30 to 40 per cent of a decline extending over four months is recovered in as many weeks." (Hamilton, July 29, 1910)

"A study of secondary reactions in bear markets will reveal the fact that the development of those movements is usually indicated by a series of minor rallies and declines, with each rally generally carrying above the preceding one, and declines terminating above immediately preceding lows. Such a formation in the averages forecasts a secondary advance even though the primary trend is down." (Rhea, 1934)

" 'Never sell a dull market' is bad advice in a major bear swing, for the market then will become dull after a sharp rally, and experienced traders will accordingly put out their shorts again." (Hamilton)

(Written Thursday, October 6th, 1960 - 2 P.M.)